

2012 PCPS Succession Survey

Gearing Up to Wind Down



Sole Proprietors

Single-Owner Practices With Employees As Well As Solo Practitioners

SUCCESSION
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Acknowledgements

The Private Companies Practice Section (PCPS) is a voluntary add-on firm membership section of the AICPA that brings together CPAs interested in the business of practice management. PCPS partners with more than 7,000 CPA firms of all sizes nationwide and provides targeted and customizable practice management tools in the areas of technical resources, business development, human resources, benchmarking and succession planning. This section is overseen by the PCPS Executive Committee, made up of CPA volunteer practitioners, which steers programs to help improve the quality of services and operating success of PCPS member firms. The PCPS Executive Committee promotes the importance of succession planning by endorsing this periodic survey.

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Introduction

Let's face it. Succession planning requires time and resources — two commodities in short supply when trying to meet deadlines, serve clients' changing needs and develop new business. Succession planning doesn't bring in new engagements, and it can take years to see a return on investment. However, it's that long-term return that makes succession planning so critical to the future of the practice — and to the retirement of the owner. Whether you're planning to turn over the practice to another CPA or to work until it's time to turn out the lights, the goal is the same: To maximize your compensation and secure your financial future.

This report summarizes selected results of the 2012 PCPS Succession Survey, a joint project between PCPS and Succession Institute, LLC. The purpose of this report is to update the profession's understanding of the succession planning challenges for CPAs and their practices, what they are doing to address them, and also provide best practices for addressing these items going forward. Of the nearly 1,000 respondents, more than 400 sole proprietors (both single-owner practices with employees as well as solo practitioners) participated. Given the depth and breadth of the data captured in the survey, we believe the results provide a clear picture of the state of succession planning for our profession.

This survey report presents a "good news, bad news" picture of succession readiness for our profession. The good news is that, compared with the results from 2008 and 2004, more CPAs are engaged in succession planning and are dealing with it more effectively.

As determined in the 2008 survey, the demographics of the sole proprietor group generally mirror the larger population. That is, many are aging baby boomers headed for retirement. As a result, we predict that over the next 10 years there will be an excess supply of practices for sale. For the past three decades, opportunities to sell or merge a practice into another have not been difficult to find. The bad news, however, is that this is not sustainable. And while well-run practices likely will have more options and greater demand for a merger or purchase, as supply increases — even with high demand — marginally run practices may have to offer bargain prices to attract buyers' attention. Therefore, CPAs seeking to retire in the near future could face disappointing marketability and valuation. Many may find themselves selling their largest personal assets at deeply discounted rates.

In well-run practices, the owner takes an active interest in creating a stronger and more viable business that is positioned for multiple exit-strategy options. Even if those owners choose to sell or merge the practice, with the multiple lucrative options available to them, they should be able to cut deals that reflect their strong position. Sole proprietors who invest time now preparing for their own departures over the next three to eight years should find themselves competitively positioned even in a buyer's market. As a result, they will face more encouraging prospects for sale and retirement.

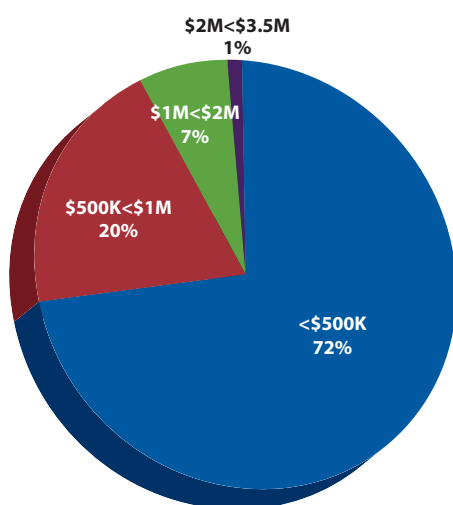
We hope you find the data and commentary helpful as you work to ensure the future success of your practice.

Who Responded?

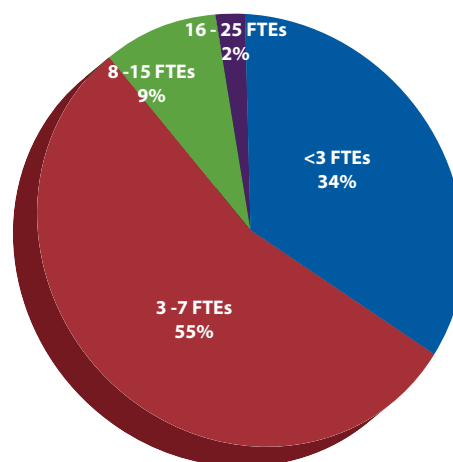
This report shows the results of 428 sole proprietors, defined as:

- Single-owner practices that employ professional staff; or
- Sole (or solo) practitioners with no professional employees, who may or may not have administrative support staff.

Respondents, by Net Annual Revenue (NAR)



Respondents, by Full-Time Equivalents (FTEs)



The survey results indicate that practices are staffed as follows:

	1-2 FTEs	3-7 FTEs	8-15 FTEs	16-25 FTEs
Equity owners	1.01	1.02	1.05	1.00
Professional employees excluding owners	1.92	3.06	6.60	11.94
Paraprofessional and administrative employees	.92	1.65	3.81	7.22
Average total FTEs ¹	1.42	4.26	10.42	19.00

¹ Total amounts do not add up to the sum of individual averages by position.

Owner compensation showed:

	1-2 FTEs	3-7 FTEs	8-15 FTEs	16-25 FTEs
Average annual owner compensation	\$111,856	\$162,612	\$282,558	\$411,111

Participants were allowed to enter minimum values in fields for revenue and compensation. These averages do not reflect the minimum default values.

In the following pages, you will find similar benchmarks to help you compare your practice to those of other sole practitioners. With regard to the staffing figures above, do you find that your practice is leveraged appropriately? Too light on professional staff? Not enough administrative support? In the area of compensation, are you bringing home more or less than your peers? Is a change of billing rates in order? These are just some of the questions we hope will prompt further thought as you plan the future of your practice.



Practice Continuation Agreements

Practice continuation agreements (PCAs) continue to be a well-kept secret among sole proprietors. Those who have them sleep better at night knowing their clients and their livelihood will be maintained in the event of unforeseen contingencies. Those without them are taking the chance that nothing will disrupt their practice for an extended period of time.

A PCA is a contract between the sole proprietor and another firm or sole proprietor (the successor firm) wherein the successor firm agrees to take over the other’s practice in the event of certain triggering events such as disability or death. Selecting the right partner for a PCA could also lend itself to a built-in purchase or merger of the firm at the time of the sole proprietor’s retirement. For more information on PCAs and a sample agreement, please visit Chapter 7 of the PCPS Succession Planning Resource Center (aicpa.org/PCPS).

There are numerous cases where the death or disability of the practice owner resulted in untold hardship for clients, staff and family members in the wake of transitioning the work to another firm. Better to identify a partner upfront, hammer out an agreement and rest better knowing that the firm’s people — both clients and employees — have a certain guarantee that life will remain somewhat stable after a hard bump in the road. Historically, few sole proprietors have had practice continuation plans, and that appears to still be the case. The lack of an agreement is consistent across practice size.


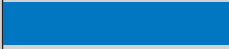



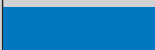







I currently have an existing PCA with another practice:

		2012	2008
Yes	<div><div></div></div>	6%	9%
No	<div><div></div></div>	94%	91%

The content of these has remained fairly steady since the last survey.



The following topics are addressed in my PCA:

		2012	2008
The conditions that trigger the agreement (e.g., retirement, death, disability after a specific period of time, etc.)		96%	91%
The party responsible for buying your practice is clearly identified		85%	55%
Upon notice of a triggering event, how fast the responsible party is required to take over the practice		69%	73%
Clear formula for calculation of the sales price of the practice (e.g., clients to be included, excluded, method for determining client value, etc.)		65%	64%
Payment period and terms		58%	55%
Definition of disability required to trigger agreement		58%	45%
Provisions for short-term disability (Does the agreement have a provision outlining the terms should the disability be temporary?)		42%	36%
Non-compete clause for disabled or retired owner (how the individual or practice taking over is protected if the disabled or retired partner decides to compete or pursue old clients)		38%	27%
Client transition requirements (in the case of retirement)		35%	0%
Plans for existing employees.(Is there an obligation to retain them for a certain period?)		31%	9%
Outline of payment to practice/person stepping in to keep the practice operating in case of short-term disability (e.g., percentage of billings, price per hour etc.)		27%	45%
Buy-back-of-practice provision should practitioner recover from disability		19%	18%
In case of short-term disability, are there quality controls to ensure acceptable work standards during this period?		19%	9%

Smaller practices (1-2 FTEs) are somewhat more likely to include the top four topics in their agreements than their larger counterparts.

Succession Plans

This area of practice management ranges far and wide, and it is important to note the difference between simply having a policy and actually executing a plan. Policies are tied to the larger, strategic business goals. They tend to be more general and less comprehensive than plans, which go much deeper into the details. Let's compare two practices — one with a *policy* and one with a *plan*.

John Smith, CPA, feels good about his succession policy. He has a documented, general strategy that calls for the implementation of a PCA about five years before his planned retirement. He has a pretty good idea of what he's looking for and has identified those characteristics in his policy. John is counting heavily on a firm that will be interested in buying his practice upon retirement. John knows he will need to spend time working with his successor to transition clients and maximize the value of his practice — also called for in his policy.

It sounds like John is on track. Now, let's compare this to the practice of Jane Doe, CPA.





Jane has a similar client list and works in many of the same geographic and niche areas as John. She has built a portfolio of devoted clients over the years and wants to ensure they're in good hands after she retires. Like John, she has spent a fair amount of time thinking about her exit strategies. Unlike John, however, Jane has gone much further in her planning. She realizes the need for a PCA and has identified three local firms as potential candidates. Jane has two employees, whom her clients love. As a result, Jane has established customized training programs and payment obligations for each of them, so they can assume the greatest client responsibilities — i.e., maximize client retention — upon transition. Additionally, she has determined a realistic estimate of the selling price she expects and is measuring her practice's performance against documented, regional benchmarks to ensure maximum value.

John has policy, and Jane has a plan. Which of these practices is better positioned for a successful transition?



Here's how sole proprietors described their intentions regarding succession plans.

The following best describes my succession plan:

		Overall	1-2 FTEs	3-7 FTEs	8-15 FTEs	16-25 FTEs
I plan to merge my practice into another practice 2-4 years before I want to retire to secure my retirement benefit and client retentions.		22%	10%	27%	35%	11%
I plan to reduce my annual hours until I'm ready to leave. I will negotiate the best possible price for my book of business.		19%	33%	12%	13%	11%
I plan to sell my clients to another CPA practice and walk away but will help transition my clients to maximize my payout.		17%	13%	20%	18%	33%
I am considering all three options.		42%	44%	41%	34%	45%














Although practice size has an impact on which option a practitioner favors, about the same percentage of each group are considering all three options.



Developing Leaders Within the Practice

Practitioners can expand their exit options by developing someone within the practice to take over in the future. When asked about plans for grooming leaders, respondents shared the following:

What I am doing right now to develop future leaders of my practice:

		2012	2008	1-2 FTEs 2012	3-7 FTEs 2012	8-15 FTEs 2012	16-25 FTEs 2012
Nothing is being done at this time		52%	NA	75%	45%	20%	11%
Identification of and training for specific competencies		39%	53%	11%	47%	76%	78%
Informal coaching by an assigned partner		24%	42%	6%	28%	49%	67%
Experiential assignments chosen to develop competencies		23%	21%	6%	26%	61%	67%
Formal training or education in delegation and supervision		18%	26%	5%	21%	41%	44%
Formal training or education in interpersonal skills		12%	17%	5%	12%	27%	44%
Formal mentoring program		6%	16%	4%	6%	20%	11%
Coaching by an outside consultant		4%	4%	1%	4%	5%	11%
State society formal leadership (partner-in-training) development programs		3%	NA	2%	2%	5%	22%
Formal in-practice partner-in-training program		2%	6%	0%	2%	12%	11%
AICPA formal leadership (partner-in-training) development programs		1%	4%	1%	0%	2%	0%
CPA practice association formal leadership (partner-in-training) development programs		1%	NA ²	1%	1%	5%	0%
Other		6%	29%	11%	3%	5%	11%

²The 2008 survey question combined AICPA and CPA Association leadership development programs.

These results are consistent with the findings from our 2011 PCPS Top Talent survey, which indicated a predominance of informal over formal mentoring programs.³

Do you receive mentoring at your firm?

		2012
Yes, informally		41%
Yes, through a formal program		37%
No		22%

Actions clearly depend on the size of the practice. Logically, practices with 1-2 FTEs have no one to develop. The larger the practice, the more likely it is to pursue one of the six top-rated activities listed.

These findings indicate that some of the sole proprietors with larger practices are seeking to leverage talent and create leaders. A lack of in-house talent clearly limits the exit strategies. Sole proprietors without employees may want to consider bringing in at least a part-timer to free them up for more complicated tasks and provide clients with another practice contact. This kind of investment can help the practice grow and become more profitable, and it enhances the practice's connection with the clients when the owner decides to leave.

For those without any employees, it is even more important to follow smart practice management procedures, such as streamlining work processes, improving the client base, increasing billing rates and growing the overall bottom line in an effort to make the practice more attractive to future buyers.

The bottom line is to begin looking at practice management decisions from a buyer's perspective. What would you pay a premium for? What would you be unwilling to pay for? The answers to these questions now will help you position your practice for higher profitability and greater marketplace value later.

³The complete results of the 2011 PCPS Top Talent survey can be found at (aicpa.org/PCPS).

Growth Expectations and Staffing

Two-thirds or more of the practitioners in all size groups expected practice growth over the next three years. Estimated growth rates range from 6.41% to more than 8% per year, with larger practices more optimistic about expansion.

Smaller practices weren't quite as upbeat. Practitioners predicting net losses in the top line expect overall revenue decreases of anywhere from 4% to 9.3% a year, with the smallest practices foreseeing the largest declines over the longest period.

Hiring practices may constrain a practice's potential growth, profits or succession options. When we asked sole proprietors about hiring, many had no plans at all, especially the smallest practices. Despite the lack of a formal plan, there is a positive growth trend as new hires slightly outpace departures.

Average new hires and departures in the last three years:

	1-2 FTEs	3-7 FTEs	8-15 FTEs	16-25 FTEs
Average annual new hires	0.18	0.61	1.25	2.22
Average annual departures	0.15	0.51	0.77	1.33

Sole proprietors of all sizes will do well to increase staff not only for expected growth but also for typical turnover. The overall value of a practice is enhanced by having enough high-quality, trained people to do the work. This is especially true in smaller markets where likely purchasers have little excess staff capacity themselves to absorb another practitioner's book of clients.








Expectations on Value and Payout Terms

Valuing the Book of Business

Among sole proprietors, 20% expect to receive less than \$1 for \$1 of billings at retirement. Nearly half expect \$1, and the rest are hoping for more.

The dollar amount I expect to be paid for my practice:

Per \$1 of client revenue		%
\$ 0.50 or less		6%
\$ 0.51 to \$ 0.99		14%
\$ 1.00		48%
\$1.01 to \$1.30		24%
\$1.31 or more		8%

Expectations varied modestly by practice size.

When it comes to a sale or merger, practice quality may be more important than book size. Quality is based on the nature and caliber of the clients and service offerings, effective hourly rates realized for work performed, staff leverage, quality of practice personnel and other factors. Thus, a sole proprietor with high-quality staff and the ability to charge market rates can expect to realize more from a sale than one who is lacking one or both of these advantages.

In any case, practitioners should be prepared to face a buyer's market, which means it will become increasingly difficult to negotiate for more than \$1 for \$1 of client billings. Furthermore, whenever a practice changes hands, there is the strong likelihood of at least some client attrition. Most buyers will pay based on client retention, and many buyers know that they should cap the payments based on the revenues per client experienced by the seller. As a result, selling CPAs can expect their actual realization to be lower than \$1 for \$1 of revenue. In our experience, even when the seller helps the buyer retain clients, the total payments made to the seller approximate about 70 cents on the dollar for the entire book sold, and could easily be as low as 60 cents on the dollar.

Payment Terms

A total of 50% expect to receive their payouts within four to five years, while about one-quarter assume they'll get them in three years. There were some variations based on practice size.

The number of years over which I expect to be paid for my practice:

		Overall %	1-2 FTEs	3-7 FTEs	8-15 FTEs	16-25 FTEs
1 year		6%	9%	6%	0%	0%
2 years		7%	14%	4%	0%	0%
3 years		23%	31%	20%	20%	0%
4 years		7%	6%	7%	5%	0%
5 years		43%	34%	48%	44%	33%
6 years		2%	0%	3%	0%	0%
7 years		4%	3%	5%	0%	11%
8 years		0%	0%	0%	0%	11%
9 years		0%	0%	0%	2%	0%
10 years		7%	3%	6%	22%	45%
More than 10 years		1%	0%	1%	7%	0%

Practices of all sizes have roughly similar expectations for a five-year payout, while smaller practices are more likely to count on a one- or two-year payout. With a sales price of less than \$700,000, some may be able to get a one- to two-year cash payout. However, for larger amounts, four- to five-year buyout time frames are more common.

In the case of expectations for more than \$1 for every dollar of revenue billed, it is unrealistic to expect a payout period of less than four to five years unless the size of the client book is very small. Sole proprietors can expect their payout to be based on client retention. Further, they should expect the buyer to establish a ceiling that limits the amount paid to whatever the selling CPA generated in fees — even if the buyer can generate higher fees with the same clients. Finally, a substantial number of buyers don't sign personal guarantees for any purchases and almost never put down money upfront. These are normally "pay-as-you-go" transactions, with payments to the seller occurring only after fees have been collected.

Succession Management Best Practices

Building a better path to succession involves enhancing the strength and value of your practice. Here's how:

Start With a 3-Year Written Plan

It takes a minimum of three years to implement the type of changes even a small practice might require to ensure more and better options for an owner's retirement. Recognize that waiting for the perfect buyer is a risky strategy. Identify the key milestones needed to move your practice forward. Assign dates, and begin actively working to achieve your plan. Begin now to make changes that will benefit the practice, turn it into a more attractive merger or acquisition candidate and secure the owner's retirement benefits.

At a minimum, your plan should address the following aspects:

- Client transition – When and how will control over long-standing clients and engagements be relinquished? How will younger staff be involved on these engagements?
- Future leaders – What kind of training should junior staff receive? Will it be on the job or through formal seminars? What will be their accountabilities and future payment obligations?
- Selling price target – How will you create a stronger and more viable business that is competitively positioned for multiple exit-strategy options?

Identify Your Exit Strategies

Options for the sole proprietor include internal succession (depending on available staff), sale, merger, or turning out the lights. Your 3-year (or more) strategic plan should encompass succession management and exit strategies to accomplish these specific and very different alternatives. Visit the PCPS Succession Planning Resource Center (aicpa.org/PCPS) to obtain a deeper understanding of each of the exit strategies and considerations for positioning your practice for a successful transition.

Construct a vision that identifies the top three changes that need to be made in order to achieve each of the exit strategies you are considering.

Implement a Practice Continuation Agreement

After choosing a local practice that is a good fit for you, enter into an agreement that covers some of the areas identified on page 7 of this report. PCPS members can find comprehensive information on these agreements in the Succession Planning Resource Center. Fine-tune and coordinate procedures to ensure a smooth transition if it becomes necessary. Don't overlook the possibility that the other practice may also be a good candidate for acquiring your practice on your retirement.

Evaluate Your Rates and Your Clients

Unless your rates and fees are similar to those charged by the party in your practice continuation agreement, you may have trouble finding someone to sign such an agreement. Also, if your average billing rates are too low, that will limit your options for buyers as well as the overall value of your practice. You may need to raise your rates and upgrade your client list.

Leverage Technology

Technology allows you to leverage your time by letting the computer do the low-value, routine functions. Options such as cloud computing provide access to state-of-the-art systems and processes without a significant investment. Consider the applications identified by other similar-sized practices in the 2012 PCPS/TSCPA National MAP Survey, also available on the PCPS website.

Strengthen Client Relationships

Strengthen relationships with your top clients and referral sources. Identify marginal clients and either motivate them to become good clients (by raising fees, moving their work out of busy season, encouraging on-time payment), or recommend another practice that better suits their needs. For more information, consult PCPS' online Practice Growth & Client Service Center.

Include an Opt-Out Clause

In the case of a merger or acquisition, perform due diligence on the other partner or partners. Ensure the quality of their system and their plan for the future. Keep in mind that it's often easier to get into business with someone than it is to get out of it. Before signing the deal, insist on a one year opt-out clause. You want to make sure it is really working, and you want to have an exit strategy in the event of an improper fit or irreconcilable differences. Frank, upfront conversations right now about how to separate will save untold time and expense down the road.



